EDITORIAL

WILL THEY ALL BE HAPPY?

OVER THE LAST 12 MONTHS a torrent of investment capital has flooded into the music products industry. Guitar Center sold $100 million worth of bonds and then $100 million in stock to the public. Steinway Musical Instrument Corp., the parent of Steinway & Sons and Selmer, sold $80 million in stock. Mark Begelman has tapped venture capitalists to help fund his ambitious chain of MARS Music and Recording Superstores. And now, as reported in this issue, Radio Shack has announced that it will plunge into the market as well with a chain of Tech America electronic superstores.

The last time the industry saw this kind of interest from outside investors was in the mid-'60s. Back then, a fertile combination of the Beatles, the baby boom, rock and roll, and a growing home organ business caught the attention of conglomerates looking for "untapped growth opportunities." Convinced that music products sales would continue rocketing upward forever, a number of big companies paid top dollar for the chance to participate. A less-than-comprehensive list includes the following transactions: Motion picture giant MCA purchased Danelectro Guitar; CBS purchased Fender, followed by Steinway & Sons, Gulbransen Organ, Gemeinhardt Flute, Rodgers Organ, and Lyon & Healy Harps; LTV Steel acquired Altec Lansing; Gulf & Western bought out Unicord, the predecessor of Korg U.S.A.; an Ecuadorian beer company merged with CMI, the parent of Lowrey, Gibson, Olds band instruments, and numerous other music businesses, to form Norlin; Macmillan Publishing bought out C.G. Conn; Whirlpool acquired Thomas Organ.

Comparing the current situation with the buying binge in the '60s reminds me of Mark Twain's observation that "History doesn't repeat itself, but it tends to rhyme." There are important differences between the conglomerates of the '60s and the current generation of investors flocking towards the music industry. For starters, this time around the investors are focusing more on the retail, not the supply, side of the business.

But that's not the only point of divergence. Conglomerate leadership in the '60s and '70s clung tenaciously to the concept of the "indivisible manager," the notion that management skills were the same in every industry and that good managers would perform equally well whether it was selling ladies ready-to-wear or farm implements. Sales plans crafted by people from the breakfast-food business and guitars designed by home appliance experts ultimately discredited the "indivisible manager" concept. To their credit, the current generation of investors places a high premium on seasoned managers with a knowledge of the specifics of our industry and a proven track record for delivering results.

Differences aside, outside investors in the music industry, both past and present, do share one important characteristic. They never have had or will have any particular affinity for music, musicians, or the products the industry offers up. Their first and last priority is generating a healthy return on their investment. When things are going well, it's easy to talk about being a long-term player and "commitment to building a business." It's the tough that display the differences between those who are committed to the industry and those who are committed only to a return on capital.

The conglomerates ran into trouble in the mid-'70s when the baby boomers grew out of their prime music buying years and industry sales growth came to an abrupt halt. Under pressure to deliver rates of growth mandated by outside investors, managers began to force sales, cut corners in production, and take an unhealthy short-term approach. A day of reckoning finally came, copious amounts of red ink flowed, and by the mid-'80s the conglomerates had liquidated or dumped their music investments at firesale prices.

The $64,000 unanswered question is whether industry growth will continue at a sufficient pace to satisfy the current crop of outside investors. If it does, there will be a lot of happy people. If it doesn't, the industry will probably live through another "day of reckoning" with companies offered up at bargain prices.

On the positive side, current management teams seem much more grounded and realistic than the high fliers in the '60s. On the negative side, unlike the conglomerates that enjoyed rock-solid balance sheets, many of the current deals in the music industry are highly leveraged, so slow, or even slower, growth is not an option. Five years from now it will be interesting to see how many of the outside investors are still excited about the music products industry.

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